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Before the
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Transfer of Parcel Post to
Competitive Product List

Docket No. MC2012-13

PUBLIC REPRESENTATIVE COMMENTS
(May 31, 2012)

Pursuant to the Commission's Notice and Order,[1] the Public Representative hereby comments on the Postal Service's request under 39 U.S.C. §3642 and 39 CFR 3020.30 *et seq.* for a classification change to transfer its Parcel Post product from the market dominant product list to the competitive product list.[2]

The Postal Service proposes to (1) remove Parcel Post from the market dominant product list; (2) add "Parcel Post," a nearly identical product, to the competitive product list; and (3) leave Alaska Bypass Service, which is currently part of Parcel Post, on the market dominant product list.[3]

I. SUMMARY OF COMMENTS

Upon review, the Public Representative concludes:

1. If transfer is authorized, inasmuch as the current Parcel Post rates recovered only 89.2 percent of attributable costs in FY 2011, as a condition of transfer, a significant overall price increase far above the price cap for market dominant products will be required for Parcel Post customers.

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[1] Notice and Order Concerning Transfer of Parcel Post to the Competitive Product List, Order No. 1328, May 1, 2012.

[2] Request of the United States Postal Service to Transfer Parcel Post to the Competitive Product List (Request), April 26, 2012.

[3] *Id*. at 1. Alaska Bypass Service allows shippers to send shrink-wrapped pallets of goods intra-Alaska at Parcel Post rates from designated "hub points" to designated "bush points." *Id.* at 2. Inasmuch as Attachment B to the Request is not paginated, citations assume it is numbered as a separate document..

2. It is fair to conclude that in the ground package retail market, the Parcel Post product is not market dominant due to competition from UPS ground and FedEx ground services. However, for some users in the single piece market who rely upon the rural nationwide Postal Service retail facilities and carrier service for Parcel Post service, the relatively limited outlets of UPS and FedEx in certain rural areas virtually eliminates them from competition in that segment of the market. The Postal Service has not addressed this issue, and there is no evidence that the Parcel Post product purchased by individual consumers relying upon such rural Postal Service retail facilities and services is not market dominant.
3. The Commission must give "due regard" to other considerations enumerated in 39 U.S.C. §3642(b)(3) before approving transfer. The actual views of users of Parcel Post and the impact on small business finances are unknown. Price increases are likely to be of greatest concern. Price increases would be capped at Priority Mail rates in the lower weight and zone rate cells, but to offset this revenue restriction, prices in remaining rate cells must be increased even further. To the extent transfer to the competitive product list may raise a concern about potential reductions in service, Universal Service Obligation requirements serve to protect against undue preferences and discrimination. However, unlike for market dominant products, service performance targets and results for competitive products, if available to the Commission at all, would be considered commercially sensitive information and would be filed under seal.[4]
4. The proposed MCS Language in Attachment C appears appropriate.

[4] 2011 ACR at 57.

II. POSTAL SERVICE REQUEST

In support of its Request as required by 39 CFR 3020.31, the Postal Service filed the following attachments:

- Attachment A—Resolution of the Governors of the United States Postal Service, March 21, 2012 (Resolution No. 12-02);[5]
- Attachment B—Statement of Supporting Justification by Karen F. Key, Manager of Shipping Products, providing information applicable to subsection 39 CFR 3020.32, and
- Attachment C—Proposed Mail Classification Schedule changes.

The Statement of Supporting Justification included as Appendix B to the Request addresses all of the Commission's requirements in 39 CFR 3020.32(a) through (i).

- Pursuant to 39 CFR 3020.32(b), the Postal Service asserts that the proposed changes are consistent with 39 U.S.C. §3622(d) because an effective rate cap provided by Priority Mail on market dominant prices assures the effect of rate increases will not be significant. It also claims that the changes will advance the objectives of 39 U.S.C. §3622(b) and take into account the factors in 39 U.S.C. §3622(c) for market dominant products. The Alaska Bypass Service will remain a market dominant product and meet the objectives of section 3622(b) with predictable and stable rates, high quality service standards, a just and reasonable schedule for rates and classifications, and provide alternative means for sending mail at reasonable costs. Request, Attachment B at 2.

- The Postal Service explains that the transfer would not result in a violation of 39 U.S.C. §3633 relating to competitive rates if there is the *necessary* price increase to insure that competitive products are not subsidized by market dominant products and that each competitive product covers its attributable costs. 39 CFR 3020.32(c). The Postal Service expresses its hope that the Commission will approve the transfer "contingent upon the Postal Service filing a notice of competitive price adjustment for Parcel Post rates which demonstrate that such rates satisfy 39 U.S.C. 3633(a) and 39 CFR part 3015." *Id.* at 3 n. 7. It refers to a similar conditional

[5] Notably, the Resolution of the Governors is to transfer "Parcel Post" from the market dominant product list. There is no exception for maintaining any part of Parcel Post as market dominant although the Request will maintain the Alaska Bypass Service as a market dominant product.

approval to transfer Standard Mail Parcels to the competitive product list.[6] *Id.* at 3.

- The Postal Service asserts that the Parcel Post product does not have sufficient market power and therefore transfer meets the requirements of 39 U.S.C. §3642(b) and 39 CFR 3020.32(d). Citing its limited market share of 17.6 percent in the ground package retail market and 1.1 percent of the total ground package market, the Postal Service contends that competitors would offer viable alternatives if it were to raise prices, degrade service or decrease output. Thus, it concludes it does not exercise *de facto* monopoly power in the market. *Id.* at 4-6.

- To comply with 39 CFR 3020.32(e), the Postal Service explains that the contents of Parcel Post pieces will be outside the scope of the letter monopoly. Any letters in such parcels shall be within the scope of the exceptions or suspensions to the Private Express Statutes, and would be expected to include only invoices, receipts, or incidental advertising. Certain incidental advertising is also permissible. In any event, the base price of a Parcel Post package is more than six times the price of a one-ounce single piece First-Class letter and therefore falls within the exception for letters in 39 U.S.C. §601(b)(1). *Id*. at 6-7.

- Comparable products offered by private sector competitors are UPS Ground and FedEx Ground services, each varying by weight and distance. 39 CFR 2020.32(f). *Id.* at 7.

- Pursuant to 39 CFR 3020.32(g), the Postal Service provides its information on the views about the appropriateness of the transfer by those who use the product. Given that current service standards will remain, those who use the product are likely concerned about the effect on prices. The Postal Service points out that a modest price increase is necessary (to 100 percent cost coverage), but that prices cannot be raised above Priority Mail rates. It explains that if rates move above parity with Priority Mail, volume would shift from Parcel Post to Priority Mail so that Priority Mail prices “act as a price cap” on Parcel Post prices. Also, Parcel Post customers in rural communities “without a competitive

[6] Docket No. MC2010-36, Order Conditionally Granting Request to Transfer Commercial Standard Mail Parcels to the Competitive Product List, Order No. 689, March 2, 2011.

package delivery market" may be concerned about attempts to limit package delivery service, but Parcel Post will continue to have the same service standards and the same reliable ground package delivery service. *Id.* at 8.

- Pursuant to 39 CFR 3020.32(h), the Postal Service asserts it is unlikely the impact on small businesses will be disproportionate. Based on its annual survey of commercial shippers, only 15 percent of Parcel Post volume is attributable to small businesses. It supports this conclusion by noting that larger commercial mails generate a significant portion of the 43 percent of Parcel Post volume that is commercial. The Postal Service concludes small businesses should not see significant changes in their mailing options. *Id*. at 9.

- Transfer to the competitive product list would provide the Postal Service the advantages of pricing and negotiation flexibility enjoyed by its competitors. 39 CFR 3020.32(i); *Id*. at 10.

III. COMMENTS AND ARGUMENT

Except as noted below, the Public Representative believes the Statement of Justification and the proposed MCS changes to be sufficient for the points asserted.

A. Competitive Products Must Cover Costs Attributable

1. Estimated rate increases

Among other provisions, 39 U.S.C. 3633(a) requires each competitive product to cover its attributable costs. The Postal Service notes that for fiscal year 2011, rates for market dominant Parcel Post had cost coverage of 89.2 percent.[7] In order for competitive Parcel Post rates to cover attributable costs, and assuming no Parcel Post price exceeds a retail Priority Mail price, Parcel Post prices must increase at least approximately 14 percent (25 rates end up being capped at Priority Rates) to achieve a 100 percent cost coverage. Although Priority Mail rates mostly exceed current Parcel Post rates, in certain low-weight, low-zone areas Priority Mail rates approximate current

[7] Request, Attachment B at 3; Docket No. ACR2011, United States Postal Service FY2011 Annual Compliance Report ("2011 ACR"), December 29, 2011 at 36.

Parcel Post rates and rate increases would be capped at the Priority Mail rates.[8] Higher weight pieces in zones 5-8 would receive larger increases than low-weight low-zone pieces because of the Retail Priority Mail cap.[9] The actual rates will likely be greater because this estimate uses FY 2011 data and does not adjust for potential lost volume due to the effects of price elasticity.

If, instead, the cost coverage were to be 105.5 percent to cover the appropriate share of institutional costs, at least a 21 percent price increase is necessary (36 rates end up being capped at Priority Rates). This is calculated with the same assumptions as above.[10]

2. Combining Parcel Post into Priority Mail in lower weights and zones

It bears noting that shifting volume to Priority Mail could be financially advantageous for the Postal Service. If all Parcel Post rates are set to the level of 100 percent attributable costs, even if they are above the Priority Mail rates for certain rate cells, then losing Parcel Post volume to Priority Mail would not reduce recovery of institutional costs. To the extent Priority Mail rates exceed attributable costs, volume shifts from Parcel Post to Priority Mail would improve Postal Service cost coverages. Additionally, setting some Parcel Post rates below 100 percent of attributable costs at the Priority Mail rate will place them “underwater.” Thus, combining Parcel Post into Priority Mail at the lower weights and zones so that Parcel Post business moves to Priority Mail, would enhance recovery of institutional costs.

3. Rate conditions

The Postal Service’s Request to condition the transfer upon “filing a notice of competitive price adjustment” is not a sufficient condition. It is considerably less explicit

[8] For instance, for SPPP Zones 1-4, 1-7 lbs are between 0 and 16 percent less than Priority Mail rates. In SPPP Zones 5-8, 1-7 lbs are between 1-40 percent less than Priority Mail rates. The remainder of rates (8-70 lbs Zones 1-8) are between 11-56 percent less than Priority Mail rates. See Appendix, compare Necessary Price Increases.xls, tabs SPPP Prices and Priority Retail Prices.

[9] See Appendix, Necessary Price Increases.xls, tab SPPP Prices for 100% CC. Rates in red are capped at the Priority Mail rate.

[10] See Appendix, Necessary Price Increases.xls, tab SPPP Prices for 105.5% CC. Rates in red are capped at the Priority Mail rate.

than the conditions applied in the Standard Mail Parcels transfer case. Any transfer authorization here should apply conditions similar to conditions imposed in that case. Transfer should be conditioned upon, if:

(1) the Postal Service files a notice of competitive price adjustment for Parcel Post rates that demonstrates such rates satisfy 39 U.S.C. §3633(a) and 39 CFR part 3015;

(2) the Commission issues an order finding that the Parcel Post rates in (1) above satisfy 39 U.S.C. §3633(a) and 39 CFR part 3015; and

(3) the Parcel Post transfer authorized by this Order is not effective until the effective date of prices authorized in (b), above.

The Appendix attached hereto demonstrates approximately the anticipated competitive Parcel Post rates and their relationship to current Priority Mail rates. To some extent, comparisons are difficult and may be misleading because competitive Priority Mail rates may be changed at any time by the Postal Service.

B. Market Power

To transfer a market dominant product, the Postal Service may not have market power defined in 39 U.S.C. §3642(b)(1):

> The market-dominant category of products shall consist of each product in the sale of which the Postal Service exercises sufficient market power that it can effectively set the price of such product substantially above costs, raise prices significantly, decrease quality, or decrease output, without risk of losing a significant level of business to other firms offering similar products. The competitive category of products shall consist of all other products.

To demonstrate that Parcel Post is not a market dominant product, the Postal Service's Statement of Justification points to its estimated FY 2010 market share of 17. 6 percent in the ground package retail market and 1.1 percent in the total ground package market. It notes that it maintains these small market shares despite lower prices than the rates charged for UPS and FedEx ground package delivery products which offer faster delivery times and, in some cases, a money back guarantee. Request, Attachment B at 5. From this, the Postal Service asserts it could not raise prices, degrade service, or decrease output without competitors offering viable alternatives; therefore, it concludes, it does not exercise *de facto* monopoly power over the market.[11]

Based upon the Commission's conclusions in the similar prior proceeding to transfer Standard Mail Parcels to the competitive product list, the Public Representative believes that competition in the ground package retail market has been demonstrated. It is not necessary for the Postal Service to provide evidence of a certainty that a significant level of business will be lost if rates are raised or service degraded. Here, as in Order No. 689, Parcel Post rates are below attributable costs, yet competitors have captured not only a significant market share, but enjoy a commanding market share.

In Order No. 689, although the Postal Service was unable to provide evidence that a significant loss in the level of business was a *certainty* if it raised rates, decreased quality, or decreased output, the Commission found that the Postal Service demonstrated the relevant market is competitive.

> Notwithstanding the Postal Service's below cost rates, in CY 2008, competitors had 20.8 percent (by volume) of the under one-pound ground parcel market….The Commission finds that the Postal Service does not have market power in the lightweight parcels market. The law does not require a certainty that business will be lost if prices are raised either significantly or significantly above costs. Rather, section 3642(b) provides that when there is a risk of losing a significant level of business to other firms offering similar products, a product (or subordinate unit) will not be classified as market dominant. The record demonstrates that such risk exists. (Citations omitted). Order No. 689 at 14-15.

The Postal Service has amply demonstrated there is at least a risk of losing a substantial amount of Parcel Post business if its rates are raised significantly or if it decreases the quality of service.

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[11] The Postal Service also implicitly suggests competition for Parcel Post customers arises from its own Priority Mail product in that Parcel Post prices cannot be raised above those rates without losing volumes to Priority Mail.

C. Additional Considerations of 39 U.S.C. 3642(b)

Section 3642(b)(3) of Title 39 requires that due regard must be given to three factors:

(1) Due regard must be given to the availability and nature of the enterprises in the private sector engaged in the product involved. Fed Ex and UPS appear to be the only enterprises engaged in the product involved. To date, no other potential competitors have been identified.

(2) Due regard must be given to the views of those who use the product on the appropriateness of the proposed action. The Postal Service identified the likely concern users of the product may have about potential rate increases and service reductions. The Postal Service's Statement of Justification attempts to address the potential views of users, but the Postal Service does not analyze carefully enough the rate impact on certain users. It does not discuss the impact of rate Increases on users in rate cells not capped by Priority Mail rates that may bear a larger share of the burden immediately and in the future if the transfer is approved.

The potential for significant price increases in the heavier weight and higher zoned Parcel Post packages may significantly impact a number of users of the Parcel Post product. The rate charts in the Appendix demonstrate the areas of greatest potential impact. Absent comments from users, the rate increase percentages are calculated and may be considered by the Commission, but the financial impact on users will be difficult to measure.

In certain rural areas competition is limited. UPS and FedEx are not as prevalent in rural areas so there is far less competition there. For example, in South Dakota there only appears to be 2 FedEx locations in the entire state (http://g.co/maps/2qerz) and 2 UPS locations in South Dakota (http://g.co/maps/4xpxf). On the other hand, there are many more Post Offices (http://g.co/maps/hhvcz). While this market condition does not necessarily lead to discrimination on the part of the Postal Service, the limited competition due to limited alternatives currently available in such areas would impose an increased burden on users of single piece Parcel Post.

(3) Due regard must be given to the likely impact of the proposed action on small business concerns. The financial impact on small businesses will vary considerably. In

any event, to comply with the requirement that each competitive product recover its costs attributable, in accordance with 39 U.S.C. 3633(a)(2), approval of the transfer will lead to an immediate increase to at least 100 percent of attributable cost or about 14 percent as shown in the Appendix.[12] The rate charts in the Appendix demonstrate the rate cell areas of greatest potential impact.

The Postal Service's conclusion that the impact on small businesses should not be disproportionate is misplaced. Request, Attachment B at 9. It cites to its own market information to demonstrate that small businesses likely make up only a small portion of its Parcel Post market. From this, it concludes that the impact on small businesses will not be disproportionate and that they should not see significant changes in their mailing options. The first conclusion is irrelevant; the second conclusion does not follow from the argument.

Relevant evidence should go to the financial impact on small businesses, no matter what portion of the Parcel Post market they represent. The Postal Service's own numbers suggest small businesses make up a not insignificant portion of Parcel Post business. Adverse financial impact on those small businesses due to significant rate increases would affect a large number of small businesses across the nation. In addition, the Postal Service does not explain how a low percentage of small businesses making up Parcel Post customers is evidence that they will not see significant changes in their mailing options.

Absent specific evidence or comments from small businesses, estimated rate increases are calculated and included in the Appendix to these Comments and may be considered by the Commission, but the impact on small businesses will be difficult to measure.

Impact on outlying delivery areas. All users of Parcel Post service and small businesses may nevertheless remain concerned about the maintenance of their service. The Universal Service Obligation offers some protections. In Order No. 689, the Commission's decision rightly observed that transfer to the competitive product list will

[12] If the Postal Service raised rates to recover 105.5 percent of attributable costs for institutional costs, the increase would amount to at least 21 percent, without taking into account the volume lost due to own price elasticity.

not excuse the Postal Service from meeting its obligation to provide universal service for the parcels:

> The Universal Service Obligation (USO) covers all mail matter, not just market dominant products.[13] The scope of the USO is addressed primarily in 39 U.S.C. 101, 403, and 407. Section 101(b) expresses Congress' policy regarding the need for effective postal service to residents of both urban and rural communities. Section 403 directs mail services throughout the United States and its territories and possessions. This is particularly important for remote areas. Section 403(a) requires rates and fees charged by the Postal Service to be fair and reasonable. Section 403(c) prohibits undue or unreasonable discrimination or preferences.
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> In addition to their considerably higher posted rates, the record indicates that competitors of the Postal Service apply costly surcharges to more than 24,000 ZIP Codes where delivery to primarily residential addresses and rural areas is more expensive. (Footnote omitted). Reasonably priced package services are particularly important to customers in all relatively isolated areas service by the Postal Service where long distances and sparse retail outlets make local purchases difficult or impossible. An essential consideration in the Commission's decision to approve the transfer is the assurance that the USO will continue to require fair and reasonable pricing and nondiscriminatory service to be available to the Postal Service's customers wherever located.
>
> The Commission is confident that while the Postal Service may establish higher prices for competitive lightweight parcels in the absence of the price cap constraint, competitive market forces will ensure that readily available small parcel delivery service to all areas will remain. Order No. 689 at 17-18.

These observations remain valid in this proceeding. The Universal Service Obligation provides a measure of assurance that competitive services may not be selectively degraded.

[13] *Report on Universal Postal Service and the Postal Monopoly*, Postal Regulatory Commission, December 19, 2008, at 19, 25 (USO Report). *See* USO Report at 18-33 for a general discussion of the scope of the USO.

D. Alternative Course of Action

If the impact on users and small businesses leads the Commission to reject the transfer, the Commission may propose combining Parcel Post into Priority Mail in the lower weights and zones to recover institutional costs from the parcels newly designated as Priority Mail volumes.

E. Proposed MCS language

The proposed *Mail Classification Schedule* modifications included as Attachment C to the Request appear appropriate, subject to minor corrections and editorial changes when, and if, Parcel Post is transferred to the competitive product list.

IV. CONCLUSION

This transfer case presents for decision the question of whether to permit a transfer when current rates do not recover attributable costs because of the price cap protecting consumers, or to approve the transfer and side-step the strong Congressional intent to maintain price caps and thereby require significant price increases and, in addition, permit future price increases without price caps, to the unknown, but potential, detriment of all Parcel Post users and small businesses. The preferable outcome would be to raise Parcel Post rates to cover attributable costs, but maintain the product as market dominant. This would forestall future price increases above the price cap, and it would maintain the requirement for publication of performance standards and performance results for the Parcel Post product.

The Public Representative respectfully submits the foregoing Comments for the Commission's consideration.

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